BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS
GARY PIERCE, Chairman
BOB STUMP
SANDRA D. KENNEDY
PAUL NEWMAN
BRENDA BURNS

IN THE MATTER OF THE APPLICATION OF JOHNSON UTILITIES, LLC, DBA JOHNSON UTILITIES COMPANY FOR AN INCREASE IN ITS WATER AND WASTEWATER RATES FOR CUSTOMERS WITHIN PINAL COUNTY, ARIZONA.

DOCKET NO. WS-02987A-08-0180

STAFF'S RESPONSE TO PETITION TO AMEND

The Utilities Division ("Staff") of the Arizona Corporation Commission ("Commission") files its response to the Petition to Amend Decision No. 71854 ("Petition") filed by Johnson Utilities, LLC ("Johnson" or "Company") on February 28, 2011. With the exception of Johnson's request to change the late fee for its sewer customers, Staff urges this Commission to deny Johnson's Petition. Staff would further urge that the proper way to address the Company's concerns would be in the Company's next rate case.

I. THE SETTING OF JUST AND REASONABLE RATES.

A. The Commission's Constitutional Authority.

Article 15, Section 3, of the Arizona Constitution provides, in relevant part, that the Commission "shall have full power to, and shall, prescribe just and reasonable classifications to be used and just and reasonable rates and charges to be made and collected by public service corporations within the State for service rendered therein." In determining just and reasonable rates, the Commission has broad discretion, subject to the obligation to ascertain the fair value of the utility's property and to establish rates that "meet the overall operating costs of the utility and produce a reasonable rate of return."[1] Under the Arizona Constitution, a utility company is entitled to a fair rate of return on the fair value of its properties, "no more and no less."[2] Arizona law does not

[1] *Scates, et al. v. Arizona Corp. Comm'n,* 118 Ariz. 531, 534, 578 P.2d 612 (App. 1978).
[2] *Litchfield Park Service Co. v. Arizona Corp. Comm'n,* 178 Ariz.45 I, 434, 854 P.2d 988 (App. 1994) (citing *Arizona Corp. Comm'n v. Citizens Utilities Co.*, 120 Ariz. 184 (App. 1978)).

mandate that the Commission (1) follow a particular method in its rate making determinations or (2) exclude consideration of relevant factors.[3]

The Commission not only sets just and reasonable rates for public service corporations, but also sets rates to protect ratepayers from overreaching by those very corporations.[4] It is the second prong, the protection of ratepayer interest that appears to be lost on Johnson. The Company's singular focus is its rights as a utility, neglecting to factor in the rights of its captive ratepayers. "The jurisprudence of our state made it plain long ago that the interests of the public service corporation stockholders must not be permitted to overshadow those of the public served."[5] The Company's arguments are no more than an attempt to undermine the Commission's responsibility of balancing of customer and utility interests at the expense of ratepayers. Protecting ratepayers, however, is part of the balancing in the public interest performed by the Commission.

B. Decision No. 71854 is supported by the evidence.

Contrary to the assertions of the Company, the record in this matter is replete with evidence to support the Commission's Decision. A decision supported by substantial evidence is not arbitrary, illegal, capricious, or an abuse of discretion and is thus valid.[6]

The Company appears to assert that the Commission may only consider the evidence presented by the parties as well as the authorities and precedent supporting the parties' position.[7] This is a narrow and strained view of the Commission's plenary rate making authority. The Commission may exercise its own independent judgment and expertise in the setting of rates.[8] The Commission considered a complete record including exhibits, testimony, and a transcript of all the proceedings. The Commission also exercised its judgment and expertise in crafting a Decision that

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[3] *Simms v. Round Valley Light & Power Company*, 80 Ariz. 145, 151, 294 P.2d 378, 382 (1956).
[4] *Scates v. Arizona Corp. Comm'n*, 188 Ariz. 531, 534, 578 P.2d 612 (App. 1978).
[5] *Ariz. Community Action Ass'n v. Ariz. Corp. Comm'n*, 123 Ariz. 228, 231, 559 P.2d 184, 187(1979); *Ariz. Corp. Comm'n v. Woods*, 171 Ariz. 286, 296, 830 P.2d 807, 817 (1992) ("The Commission was not designed to protect public service corporations and their management, but rather, was established to protect our citizens from the results of speculation, mismanagement and the abuse of power.").
[6] *See Nutek Information Systems v. Arizona Corp. Comm'n*, 194 Ariz. 104, 107-08 ¶ 15, 977 P.2d 826, 829-30 (App. 1998); *Arizona Corp. Comm'n v. Citizens Utilities Company*, 120 Ariz. 184, 187, 584 P.2d 1175, 1178 (App. 1978); *Porter v. S.C. Pub. Serv. Comm'n*, 507 S.E.2d 328, 332 (S.C. 1998) (holding that "the possibility of drawing two inconsistent conclusions from the evidence does not prevent a court from concluding that substantial evidence supports an administrative agency's finding")
[7] Petition at 5.
[8] *See. Citizens,* 120 Ariz. 184, 190, 584 P.2d 1175, 1181 (1978).

balances the needs of the Company, protects the Company's ratepayers and comports with the requirements of the state Constitution. The Commission is the ultimate arbiter of the record presented and renders its decision accordingly. The Commission did so in this case.

II. RESPONSE TO THE COMPANY'S REQUESTED AMENDMENTS.

A. Johnson requests to modify the $40 late fee in the sewer tariff.

Staff supports the Company's request to modify the $40 late fee to be consistent with the water division late charge of 1.5 percent of the past due balance per month. However, if the Commission does not wish to re-open this case even for this limited reason, Staff would not object to leaving the $40 late fee as is since the unintended consequence of this fee has been a substantial reduction in late sewer bill payments.

B. The Commission should reject the Company's request to add $10,892,391 back into rate base for inadequately supported plant.

The Company continues to argue that the Staff reduction is arbitrary. According to Company witness Tompsett, the Company provided "contracts, invoices, cancelled checks and/or main extension agreements in support of all but $885,064".[9] Despite the fact that the Company submitted voluminous documents (see generally Exhibit A-69), Staff's audit and analysis could not verify the Company's claims. The audit process was difficult and was compounded by the lack of timeliness of the response of the Company as well as the failure of the Company to keep its records in accordance with the National Association of Utility Commissioners ("NARUC") Uniform System of Accounts ("USOA") and Commission Rules.[10] The Commission's Decision is consistent with prior orders and is not arbitrary.

Staff's conclusion regarding the inadequacy of the Company's documentation is corroborated by a similar conclusion reached in the 2006 audit report prepared by Henry & Horne. The report stated:

> Because of the inadequacy of accounting records for the years prior to 2006, we were unable to form an opinion regarding the amounts at which utility plant in service and accumulated depreciation are recorded in the accompanying balance sheet at

[9] Ex. A-5 at 12.
[10] Ex. S-38 at 13.

December 31, 2006, (stated at $168,974,434 and $8,930,075 respectively), or the amount of depreciation expense from the year then ended (stated at $1,799,271).[11]

The Company continues to shift the focus away from its failure to comply with Commission rules and Commission decisions; by its constant reiteration that adequate documentation was provided. It was uncontroverted that the Company failed to keep its books and records in accordance with Commission rules[12] and in accordance with the NARUC Uniform System of Accounts.[13] The evidence was uncontroverted that Johnson failed to comply with the very Commission Decision that granted Johnson's certificate of convenience and necessity.[14]

While the Company continues to maintain that it provided Staff continually with documents to support its plant, it was not always timely. In a letter dated ***April 21, 2009***, the Company supplemented its response to a Staff data request, a data request that ***was issued in August 2008***. This information was provided a mere **two** days before the commencement of the hearing. It is unreasonable to require Staff to audit those records on the eve of trial. But despite the lateness of the responses Staff, nevertheless, attempted to review the provided documents.[15]

In its Petition, Johnson states that it retained Waterworks Engineers to prepare a replacement costs new ("RCN") and a replacement costs less depreciation ("RCND) Study. While RCN/RCND studies are helpful in determining plant values, such studies do not determine whether such plant was the subject of investment by a utility or whether such plant was paid for or installed by customers or developers. Plant that is contributed is plant that should not be placed into rate base and thus earn a return.

In a recent Commission decision regarding Arizona-American Water Company, a Class A utility, the Commission disallowed over $2,015,170 in plant for inadequate documentation.[16] Arizona-American argued that it had engineering estimates for the plant and that the plant was providing service and that it would be punitive to exclude the estimated unsupported costs. The

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[11] Ex. S-45 at 15.

[12] Arizona Administrative Code ("A.A.C.") § R14-2-610 D.1. This rule states in part: "Each utility shall keep general and auxiliary accounting records reflecting the *cost of its properties*... and all other accounting and statistical data *necessary to give complete and authentic information as to its properties*..." (emphasis added).

[13] NARUC USOA 13.

[14] Decision No. 60223 (May 27, 1997) at 14-15.

[15] Tr. 1713:22-25; 1714:1-7.

[16] Decision No. 71410 (December 8, 2009).

Commission disagreed with the Arizona-American arguments and adopted Staff's recommended disallowance, which was 100% for the plant is question.

Decision No. 71854 is in line with other Commission decisions on the inadequacy of documentation. The Company's request should be denied.

C. Affiliate Profits were properly deducted.

As the Company acknowledges,[17] the Commission has the authority to exclude affiliate profit from plant in service. The Commission rule governing affiliate transactions is A.A.C. R-14-2-801 *et seq.* A.A.C. R-14-2-804(A) provides:

> A utility will not transact business with an affiliate unless the affiliate agrees to provide the Commission access to the books and records of the affiliate to the degree required to fully audit, examine or otherwise investigate transactions between the public utility and the affiliate. In connection therewith, the Commission may require production of books, records, accounts, memoranda and other documents related to these transactions.

This Commission, as well as other state commissions, has historically reviewed affiliate costs and profits with greater scrutiny than other utility costs.

In *U.S. West Communications v. Arizona Corp. Comm'n*, 185 Ariz. 277, 915 P.2d 1232 (App. 1996), the Arizona Court of Appeals held that the "Commission has broad powers to scrutinize transactions between a regulated company and its unregulated affiliates" and disallow excessive costs.[18]

It is part of the duty and responsibility of a regulated utility to serve its public in a fair and equitable manner. A utility cannot overcharge customers or buy services from related entities at extravagant prices and expect its ratepayers to pay for it. A utility has an obligation to get the best price for services to customers. This includes the obligation not to promote profitability for the Company or another interested company in a transaction that may not be at arm's length to the detriment of its customers.

Staff could not determine whether the transactions between Johnson and its affiliates were at arm's length. Johnson had a number of affiliates that provided services to the utility. The Company indicated that for the years 1998-2003 construction of water and wastewater plant was done by an

[17] Petition at 8.
[18] 185 Ariz. at 282, 915 P.2d at 1237 (citations omitted).

affiliate, Boulevard Contracting Company Inc.[19] The Company indicated that the owner was George Johnson. Records from the Commission's Corporation division indicated that Boulevard's date of incorporation was December 18, 1998 and list George Johnson as President and Chief Executive Officer, and Jana Johnson as secretary. Corporation division records also indicated that Boulevard has been administratively dissolved for failure to file its annual report.

The Company has identified Central Pinal Contracting, LLC ("CPC") as the entity that provided the construction work after 2003. According to records from the Commission's Corporation division, from 2003 to 2008, the manager of CPC was Atlas Southwest, Inc., and the member was Crisbar, LLC.[20] The Company indicated in response to a Staff data request, that Brian Tompsett was also an owner.[21] In April 2008, CPC's ownership changed. Currently the managers are Barbara A. Johnson and Christopher Johnson. The managers are the son and daughter of George Johnson. The member of CPC is the Roadrunner Trust, Barbara A. Johnson and Christopher Johnson, co-trustees. Because of this change in ownership, the Company maintains that CPC is no longer an affiliate and thus any transaction are not required to be reported pursuant to the Commission's affiliated interest rules.[22]

The Company indicated that the construction affiliates were not formed solely to provide services to the Company, but did not produce any other agreements with non-affiliated entities.[23]

The Company claims that it competitively bid its construction projects but did not retain those bids, so Staff could not conduct an audit. As Staff testified, fair competitive bids protect ratepayers from being charged too much for plant.[24] As the testimony shows, Mr. Tompsett was a part owner of CPC and at the same time an executive of the Company.[25] Although he indicates that he did not participate in the bidding and the review process of the bids, his role as an owner of the construction affiliate and an executive in the Company appear to be in conflict.

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[19] Ex. S-20.
[20] Ex. S-3; Ex. S-4.
[21] Ex. S-20.
[22] *Id.*; TR 857:2-9.
[23] Tr. 1207:1-7.
[24] Ex. S-38 at 12.
[25] The Company has informed Staff that Mr. Tompsett is no longer with Johnson Utilities.

The Company complains that the adjustment is overstated because Staff "improperly assumed that all plant recorded on the Company's books was constructed by affiliates."[26] The Company provided Staff with a copy of an external audit of its financial statements conducted by the public accounting firm of Henry & Horne. The audit was conducted in conjunction with the proposed sale of assets by Johnson to the Town of Florence.[27] Note 3 to the financial statements regarding related parties stated that the affiliate contracts to perform substantially all of the water and sewer system construction for the Company.[28] Further in Staff's review of canceled checks and bank statements submitted by the Company in support of payments made for plant, Staff's review noted payments to a Company affiliate.[29] The bank records did not indicate payments made to any other construction entity other than an affiliate. Staff selected the midpoint (7.5) of the range of 5% to 10% mark-up range found in the documentation provided to Staff by the Company.[30]

With respect to the wastewater division, the Company claims that it provided evidence and testimony that affiliate-constructed wastewater plant totaled only $45,724,508.[31] However, Staff's audit of the Company's bank records was unable to verify this amount.[32]

D. <u>Unexpended Water Hook-up fees were properly deducted from Rate Base.</u>

Johnson's method for collecting hook-up fees is not typical, which the Company even acknowledges.[33] Johnson collects hook-up fees well in advance of providing service to the customers for whom the hook-up fee is credited. Under a typical approach, a utility builds capacity in advance and then collects hook-up fees individually upon each new connection.[34]

Staff contends that the treatment accorded to funds contributed by others does not depend on whether the funds are unexpended. The characterization of hook-up fees (or CIAC) does not hinge upon whether the fees are spent or unexpended but whether or not the funds were: (i) provided by someone other than the Company's owner/investor; (ii) is non-refundable; and (iii) whether the

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[26] Company Closing Brief at 4; 15.
[27] Docket No.WS-02987A- 07-0203.
[28] Ex. S-45 at 14.
[29] *Id.* at 11.
[30] *Id.* at 13.
[31] Company Closing Brief at 17.
[32] Ex. S-45 at 12.
[33] Ex. A-2, Vol. II at 18.
[34] Ex. S-39 at 5.

purpose of the CIAC is to fund the plant. Further, the removal of unexpended CIAC from the CIAC account is inconsistent with the NARUC USOA.[35] NARUC USOA states the following regarding CIAC:

> 271. Contributions in Aid of Construction
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> A. This account shall include:
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> 1. Any amount or item of money, services or property received by a utility from any person or governmental agency, any portion of which is provided at no cost to the utility, which represents an addition or transfer to the capital of the utility, and which is utilized to offset the acquisition, improvement or construction costs of the utility's property, facilities or equipment used to provide utility services to the public.

The unexpended CIAC are funds that can be used by the Company, thus the Company's rate base should be reduced by the CIAC.[36] Reducing rate base by CIAC preserves the ratemaking balance and removes the possibility of the Company earning an excess.

The Company argues that the Staff recommendation would create a mismatch and that existing customers receive a windfall.[37] It is precisely the non-typical method that the Company uses to collect hook-up fees that has created the balances of the magnitude that are seen in the instant case.

The Commission has addressed the issue of unexpended advances in Decision No. 70011 and Decision No. 70360.[38] In both those cases, the utilities contended that it would be unfair to exclude advances from rate base if plant associated with the advance was not in service during the test year. The Commission rejected the utilities' arguments. The Company has not advanced any compelling argument to warrant a departure from normal rate-making treatment.

E. <u>The Hook-up Fee was properly discontinued.</u>

Because of the magnitude of the CIAC balances, Staff recommends that the hook-up fee be discontinued. Staff found that there was little equity in the Company's capital structure. While Staff is supportive of the use of hook-up fees, there should be a balance between the amount of equity the Company is investing in plant and what customers are investing in plant through hook-up fees.[39] The

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[35] Ex. S-38 at 18.
[36] *Id.* at 18-19.
[37] Ex. A-2, Vol III at 21-22.
[38] UNS Gas, Docket No. G-04204A-06-0463; UNS Electric, Docket No. E-04204A-06-0783.
[39] Ex. S-38 at 35.

Decision properly discontinued its use. There is nothing to preclude the Company from seeking a hook-up fee tariff at a later date or from requesting one in its next rate case.

F. The Company's request of a rate of return should be rejected.

The Company has requested a rate of return in the range of 8.18% to 11.89%. Staff did not recommend a rate of return because the Company, under Staff's recommendation, had a negative rate base for both water and sewer; Staff set rates based on an operating margin.

To determine the cost of capital, the Commission must first determine the appropriate capital structure, i.e., the ratio of debt and equity which finances the company's investments.[40]

The Commission has discretion in determining a utility's capital structure.[41] Once the appropriate capital structure for rate-making purposes is ascertained, the costs of each component must be determined.[42] The cost of debt is usually readily determined, as it generally reflects the prevailing market interest rate.[43] The determination of the cost of equity is more difficult; this determination involves the judgment of the Commission in determining the appropriate cost of equity capital.[44]

Ratepayers benefit from financially sound utilities. However, ratepayers can also be unnecessarily burdened when a capital structure is too equity rich for setting just and reasonable rates.

The Company's capital structure is heavily laden with equity (2.79% long-term debt and 97.21 percent equity). RUCO recommended that the Commission impute a hypothetical capital structure composed of 40 percent long term debt and 60 percent equity.[45] Should the Commission grant the Company's request, Staff would urge the adoption of a hypothetical capital structure as proposed by RUCO. However, the Decision was correct and the Company's request should be rejected.

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[40] *Litchfield Park* 178 Ariz. at 434-35, 874 P.2d at 991-92.
[41] *See Citizens* 120 Ariz. at 190, 584 P.2d at 1181; *Litchfield Park.* 178 Ariz. at 435, 874 P.2d at 992.
[42] *Litchfield Park* 178 Ariz. at 435, 874 P.2d at 992.
[43] *Id.*
[44] *Litchfield Park* 178 Ariz. at 435, 874 P.2d at 992, citing *Sun City Water Company*, 26 Ariz. App. at 309, 547 P.2d at 1109.
[45] Ex. R-9 at 3.

G. Post Test Year Plant for the Wastewater Division was properly excluded.

As the Company notes in its Petition, it "discovered" that $2,201,386 (Hunt Highway) of plant originally classified at post test year plant and booked to plant in 2008 was actually placed into service in 2007. That this plant was "discovered" at the time of the Company's filing of its rebuttal testimony, almost one year from the filing of its application and supports the Staff's position that the Company failed to keep its books and records properly, which also lends further support to Staff's recommended disallowance. The Company also seeks to include in rate base $1,021,076 of post-test year plant for the Parks Lift Station and the Queen Creek Leach Field project.

Commission rules require the end of the test year, which is the one-year historical period used in determining rate base, operating income and rate of return, to be the most recent practical date available prior to the filing.[46] Compliance with Commission rules and recognition of Commission policy on appropriate test year selection requires a utility to choose a test year that includes all major rate base and operating income items needed to support its rate application, and to include pro forma adjustments to its chosen test year that are consistent with past Commission action under similar circumstances.

While the Commission has allowed the inclusion of post-test-year plant in rate base, Staff has traditionally recognized two such scenarios: (1) when the magnitude of the investment relative to the utilities total investment is such that not including the post-test-year plant in the cost of service would jeopardize the utility's financial health, and (2) when conditions such as the following exist: (a) the cost of the post-test-year plant is significant and substantial, (b) the net impact on revenue and expenses for the post-test-year plant is known and insignificant or is revenue-neutral, and (c) the post-test-year plant is prudent and necessary for the provision of services and reflects appropriate, efficient, effective, and timely decision-making.[47] It is the Company's burden to show that the post-test-year plant is revenue neutral. The Company failed to meet this burden.

The Company, contrary to its assertions in its Petition, provided no credible evidence, other than conclusory statements that the Park Lift Station was necessary to resolve "potential problems".[48]

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[46] *See* A.A.C. R14-2-103(A)(3)(p).
[47] Ex. S-44 at 9.
[48] Ex. A-5 at 34.

Further, the Company did not provide any evidence that the additions were revenue neutral. It is the Company's burden to show that the post-test-year plant will not add to revenues.

The Company, in its Petition, cites to several past Commission decisions in support of its position to include post-test-year plant, all of which are distinguishable from this case.

H. <u>The Decision properly excluded income tax expense.</u>

The Company is seeking recovery of $1,185,679 as income tax expense and continues to argue that it should be allowed to recover income tax expense even though it is organized as a limited liability company and does not pay income tax. The following exchange between RUCO's attorney and Company witness Thomas Bourassa illustrates the position of the Company:

> Q. (Mr. Pozefsky): Would it be fair to say, Mr. Bourassa that the company is asking to recover income tax that the company itself did not pay to the State or to the IRS?
>
> A. (Mr. Bourassa): You are making a technical distinction.
>
> Q. What's the answer?
>
> A. The answer is no. The LLC or the partnership doesn't pay the taxes directly on their returns.[49]

While the Company claims it is a "technical" distinction, the Company is asking for recovery of taxes that it does not pay, and it admits that it does not pay taxes. Further the Company elected a form of business to take advantage of the benefits of being an LLC, such as the avoidance of double taxation that exists for C-corporations.[50] Johnson elected to organize itself as an LLC, which is a pass-through entity for purposes of income tax liability.

Notwithstanding Johnson's status as a tax pass-through entity, the Company also claims that Staff's proposed treatment is somehow unfair, and continues to compare itself to a C-corporation subsidiary of a holding company. The Company argues that its situation is analogous to a subsidiary C-Corp utility of a parent holding company whose tax return is consolidated with the parent.[51] But what the Company fails to acknowledge is that, in that scenario there is usually evidence of the tax rate. There is no such evidence in this case. The Company failed to provide any evidence regarding

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[49] Tr. 1357.
[50] Tr. 1350:3-24.
[51] Company Closing Brief at 32.

the tax rates of its members or that its members even paid any taxes. Further, Mr. Bourassa testified that the basis for the Company's request is an agreement between Johnson and its members to reimburse for the tax liability.[52] The ratepayers are not parties to such an agreement. Staff was not provided a copy of this agreement to verify the nature of the arrangement.

In support of its position, the Company in its closing brief cites decisions from several jurisdictions which indicate a split; some jurisdictions allow income tax expense for pass-through entities and others do not.[53] For example, in *Re Shoreham Telephone Company Inc*, 2004 WL 2791514 (Vt.P.S.B.), the Vermont Public Services Board denied recovery, stating:

> We recognize that Shoreham's owners as individuals, and like many other investors, will pay income tax on earnings and distributions from the Company. Under federal and state tax law, these sources of income are taxed at the owners' personal income tax rate. This is a direct corollary of Shoreham's internal decision to choose a Subchapter S corporate form and enjoy its attendant benefits. These tax obligations are not, however, expenses that Shoreham (as an incorporated entity) itself must pay. In essence they are an additional form of compensation to investors (who also happen to be employees). In some future case Shoreham might (or might not) be able to justify such payments as a form of employee compensation, or as a necessary payment for capital. However, in this case Shoreham claimed compensation for these costs as income taxes, which they are not. Thus, they cannot be included among the Company's recognized costs of service.

Contrast this Vermont decision to one from Wisconsin. In *Re CenturyTel of Midwest-Kendall, Inc*, 2001 WL 1744202 (Wis.P.S.C.), the Wisconsin Public Service Commission allowed recovery. Century Tel-Kendall was an LLC that had previously been a corporation and was now requesting income taxes as part of its revenue requirement. Century Tel-Kendall paid taxes to its ultimate parent, and the parent filed a consolidated return for all of its affiliates and subsidiary. The Wisconsin Public Service Commission found that there was evidence in the record of the corporate tax rate and acknowledged that the operations of Century Tel-Kendall generated taxable income and thus allowed recovery. In the instant case, Johnson is not a subsidiary of a parent who files consolidated returns.

To bolster its argument regarding the allowance of income tax expense the Company cites *ExxonMobil Oil Corp. v. Federal Energy Regulatory Comm'n* 487 F.3d 945, 376 U.S.App.D.C. 259 (D.C. Cir. 2007), as support for the allowance of income tax recovery for pass-through entities.

[52] Tr. 1352:16-21.
[53] Company Closing Brief at 34.

However, its reliance on *ExxonMobil*[54] is misplaced and is distinguishable from the instant case. The decision by FERC to allow recovery of income tax expense did not come easy and FERC's process of developing an allowance policy has a "tortuous history".[55] FERC determined that it would permit an income tax allowance for all entities or individuals owning public utility assets provided that an entity or individual has an actual or potential income tax liability to be paid on that income from those assets.[56] In the instant case, there is no record of tax liability of the members of Johnson. The potential for tax liability is negated by the agreement for reimbursement between the Company and its members.

The Commission is the body empowered by the Constitution and by the people to regulate public service corporations.[57] As such, the Commission, in the exercise of its ratemaking authority has the power to disallow the recovery of income tax expense for pass-through entities. The Arizona Court of Appeals, in the *Consolidated Water Utilities v. Ariz. Corp. Comm'n* case made it clear that it is within the discretion of the Commission allow or disallow income tax expense.[58] There, the Court held that "the decision to allow or disallow . . . tax expense is to be made by the Commission, and not the Courts."[59]

The Commission agreed to examine the income tax issue in a series of workshops.[60] A Commission policy statement regarding the imputation of income tax expense is expected sometime in the future.

III. CONCLUSION.

There are a myriad of problems associated with amending the Decision, starting with adjusting rates in 2011 based on a 2007 test year. The Company has met with Staff to discuss its record keeping plan. With the proper procedures and a robust record keeping plan, hopefully the problems identified by the Commission will be eliminated, or at least diminished. Many of the

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[54] *ExxonMobil Oil Corp. v. Federal Energy Regulatory Comm'n* 487 F.3d 945, 376 U.S.App.D.C. 259 (D.C. Cir. 2007).
[55] *Id.* at 948.
[56] *Id.* at 950.
[57] *See* Article 15, Section 3 Arizona Constitution.
[58] 178 Ariz. 478, 875 P.2d 137 (1993).
[59] *Id.* at 484, 143.
[60] *See* Decision No. 72177; also Docket No. W-00000C-06-0149.

Company's issues can be resolved in the Company's next rate case. Staff would urge the Commission to deny the Company's requests and leave Decision No. 71854 undisturbed.

RESPECTFULLY SUBMITTED this 1st day of June, 2011.

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